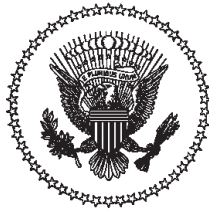

THE STATE OF SMALL BUSINESS

A REPORT
OF THE
PRESIDENT

1996

THE STATE OF SMALL BUSINESS



A REPORT OF THE PRESIDENT

1996

Together with the Office of Advocacy's Annual Report on Small Business and Competition and the Annual Report on Federal Procurement Preference Goals of the U.S. Small Business Administration

United States Government Printing Office
Washington: 1997

ISSN: 0735-1437

ISBN: 0-16-049304-8

For sale by the U.S. Government Printing Office
Superintendent of Documents
Mail Stop: SSOP
Washington, DC 20402-9328

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*For detailed tables of contents of *The Annual Report on Small Business and Competition* and *The Annual Report on Federal Procurement Preference Goals*, see pages 17 and 331.

THE

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A REPORT

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The State of Small Business: A Report of the President

To the Congress of the United States:

I am pleased to present my fourth annual report on the state of small business. In short, the small business community continues to perform exceptionally well. For the fourth year in a row, new business formation reached a record high: 842,357 new firms were formed in 1996.

The entrepreneurial spirit continues to burn brightly as the creativity and sheer productivity of America's small businesses make our Nation's business community the envy of the world. My Administration has worked hard to keep that spirit strong by implementing policies and programs designed to help small businesses develop and expand. We have focused our economic strategy on three pillars: reducing the deficit, opening up markets overseas, and investing in our people through education and technology. Our efforts with respect to small business have been concentrated in a number of specific areas, including directing tax relief to more small businesses, expanding access to capital, supporting innovation, providing regulatory relief, opening overseas markets to entrepreneurs, and strengthening America's work force.

A Balanced Budget and Taxpayer Relief

When I took office, the federal budget deficit was a record \$290 billion. I determined that one of the best things we could do for the American people, including small business, would be to balance the budget. Because of our hard choices, the deficit has been reduced for five years in a row. By October 1997, the deficit had fallen to just \$22.6 billion—a reduction of \$267 billion or 90 percent. These lower deficits have helped to reduce interest rates, an important matter for all small businesses.

Small business owners have long recognized the importance of this issue. At each of the White House Conferences on Small Business—in 1980, 1986, and 1995—small businesses included on their agenda a recommendation to balance the federal budget. With passage of the Balanced Budget Act of 1997, I signed into law the first balanced budget in a generation. The new budget will spur growth and spread opportunity by providing the biggest investment in higher education since the GI bill more than 50 years ago. Even after we pay for tax cuts, line by line and dime by dime, there will still be \$900 billion in savings over the next 10 years.

And at the same time we are easing the tax burden on small firms. My Administration and the Congress took the White House Conference tax recommendations seriously during deliberations that led to the Taxpayer Relief Act of 1997. The new law will direct billions of dollars in tax relief to small firms over the next 10 years. Small businesses will see a decrease in the estate

tax, an increase to 100 percent over the next 10 years in the percentage of health insurance payments a self-employed person can deduct, an updated definition of “home office” for tax purposes, and a reduction in paperwork associated with the alternative minimum tax.

Significant new capital gains provisions in the law should provide new infusions of capital to new small businesses. By reducing the capital gains tax rate and giving small business investors new options, the law encourages economic growth through investment in small businesses.

Access to Capital

For so many small business owners, gaining access to capital continues to be a very difficult challenge. The U.S. Small Business Administration (SBA) plays a key role as a catalyst in our efforts to expand this access. The Agency made or guaranteed more than \$13 billion in loans in 1997. Since the end of fiscal year 1992, the SBA has backed more than \$48 billion in loans to small businesses, more than in the previous 12 years combined. In 1997, the SBA approved 45,288 loan guaranties amounting to \$9.46 billion in the 7(a) guaranty program, a 23 percent increase from 1996, and 4,131 loans worth \$1.44 billion under the Certified Development Company loan program.

Included in the 1997 loan totals were a record \$2.6 billion in 7(a) and CDC loans to more than 10,600 minority-owned businesses and another record \$1.7 billion in roughly 10,800 loans to women-owned businesses. Over the last four years, the number of SBA loans to women small business owners has more than tripled, and loans to minority borrowers have nearly tripled.

The Small Business Investment Company (SBIC) program, the SBA's premier vehicle for providing venture capital to small, growing companies, produced a record amount of equity and debt capital investments during the year. The program's licensed SBICs made 2,731 investments worth \$2.37 billion. In 1997, 33 new SBICs with combined private capital of \$471 million were licensed. Since 1994, when the program was revamped, 111 new SBICs with \$1.57 billion in private capital have entered the program.

And in the past year, the SBA's Office of Advocacy developed a promising new tool to direct capital to dynamic, growing small businesses—the Angel Capital Electronic Network, or ACE-Net. This effort has involved refining federal and state small business securities requirements and using state-of-the-art Internet technology to develop a brand new nationwide market for small business equity.

Government Support for Small Business Innovation

As this report documents, small firms play an important role in developing innovative products and processes and bringing them to the marketplace. Federal research and development that strengthens the national defense, pro-

notes health and safety, and improves the nation's transportation systems is vital to our long-term interests. Our government has instituted active policies to ensure that small businesses have opportunities to bring their innovative ideas to these efforts.

The Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs help ensure that federal research and development funding is directed to small businesses. In fiscal year 1996, more than 325 Phase I and Phase II STTR awards totaling \$38 million went to 249 small businesses. Also in 1996, the SBIR program invested almost \$1 billion in small high technology firms. The program has touched and inspired individuals like Bill McCann, a blind—and once frustrated—trumpet player who used SBIR funding to help start a company that designs software to automatically translate sheet music into braille. Today, Dancing Dots Braille Music Technology is rapidly expanding the library of sheet music available to blind musicians.

Other initiatives include the National Institute of Standards and Technology's Advanced Technology Program, enabling small high technology firms to develop pathbreaking technologies, and NIST's Manufacturing Extension Partnership, which helps small manufacturers apply performance-improving technologies needed to meet global competition. Two of the SBA's loan programs—the 7(a) and 504 loan programs—currently assist 2,000 high technology companies. And the SBA's ACE-Net initiative is especially designed to meet the needs of these dynamic high technology firms.

Because they give small firms a footing on which to build new ideas and innovative products, these efforts benefit not only the small firms themselves, but the entire American economy.

Regulatory Relief

A pressing concern often identified by small businesses is unfairly burdensome regulation. My Administration is committed to reforming the system of government regulations to make it more equitable for small companies. In 1996, I signed into law the Small Business Regulatory Enforcement Fairness Act, which strengthens requirements that federal agencies consider and mitigate unfairly burdensome effects of their rules on small businesses and other small organizations. A small business ombudsmen and a new system of regulatory fairness boards, appointed in September 1996, give small firms new opportunities to participate in agency enforcement actions and policies. Because agencies can be challenged in court, they have gone to extra lengths to ensure that small business input is an integral part of their rulemaking processes.

Many agencies are conducting their own initiatives to reduce the regulatory burden. The SBA, for example, cut its regulations in half and rewrote the remaining requirements in plain English. All of these reforms help ensure that the government maintains health, safety and other necessary standards without driving promising small companies out of business.

Opening Overseas Markets

Key in my administration's strategy for economic growth are efforts to expand business access to new and growing markets overseas. I want to open trade in areas where American firms are leading—computer software, medical equipment, environmental technology. The information technology agreement we reached with 37 other nations in 1996 will eliminate tariffs and unshackle trade in computers, semiconductors, and telecommunications. This cut in tariffs on American products can lead to hundreds of thousands of jobs for our people.

Measures aimed at helping small firms expand into the global market have included an overhaul of the government's export controls and reinvention of export assistance. These changes help ensure that our own government is no longer the hurdle to small businesses entering the international economy.

A 21st Century Work Force

American business' most important resource is, of course, people. I am proud of my Administration's efforts to improve the lives and productivity of the American work force. We know that in this Information Age, we need a new social compact—a new understanding of the responsibilities of government, business, and every one of us to each other.

Education is certainly the most important investment we can make in people. We must invest in the skills of people if we are to have the best educated work force in the world in the 21st century. We're moving forward to connect every classroom to the Internet by the year 2000, and to raise standards so that every child can master the basics.

We're also training America's future entrepreneurs. The SBA, for example, has improved access to education and counseling by funding 19 new women's business centers and 15 U.S. export assistance centers nationwide. And we are encouraging businesses to continue their important contributions to job training. The Balanced Budget Act of 1997 encourages employers to provide training by excluding income spent on education for employees from taxation.

We are taking steps to improve small business workers' access to employee benefits. Last year, I signed into law the Small Business Job Protection Act, which, among other things, makes it easier for small businesses to offer pension plans by creating a new small business 401(k) plan. We made it possible for more Americans to keep their pensions when they change jobs without having to wait before they can start saving at their new jobs. As many as 10 million Americans without pensions when the law was signed could earn them because this law exists.

Given that small businesses have created more than 10 million new jobs in the last four years, they will be critical in the implementation of the welfare to work initiative. That means the SBA microloan and One-Stop Capital Shop

programs will be uniquely positioned to take on the “work” part of this initiative. The work opportunity tax credit in the Balanced Budget Act is also designed as an incentive to encourage small firms, among others, to help move people from welfare to work.

A small business starts with one person's dream. Through devotion and hard work, dreams become reality. Our efforts for the small business community ensure that these modern American Dreams still have a chance to grow and flourish.

I want my Administration to be on the leading edge in working as a partner with the small business community. That is why an essential component of our job is to listen, to find out what works, and to go the extra mile for America's entrepreneurial small business owners.

A handwritten signature in black ink, reading "William Clinton". The script is fluid and cursive, with a prominent "W" and "C".

THE WHITE HOUSE

THE ANNUAL

REPORT ON

SMALL

BUSINESS

AND COMPETITION

THE OFFICE OF ADVOCACY

U.S. SMALL BUSINESS

ADMINISTRATION

Letter of Transmittal

Mr. President:

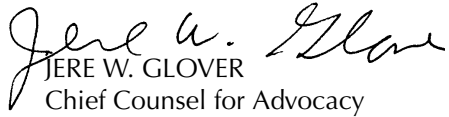
The United States Small Business Administration herewith submits its 1996 Report on Small Business and Competition in accordance with the Small Business Economic Policy Act of 1980. The report was prepared by the Office of Advocacy of the U.S. Small Business Administration.

We are pleased to present this report and to work with you on behalf of this important sector of the economy.

Sincerely,



AIDA ALVAREZ
Administrator



JERE W. GLOVER
Chief Counsel for Advocacy

Executive Summary

Nineteen-ninety-five was a good year for the U.S. economy and for small business. Some 3.2 million new jobs were created and real GDP increased by 2 percent. The rate of unemployment fell from 6.1 percent in 1994 to 5.6 percent in 1995. Consumer prices were stable, employee compensation increased and, for the sixth consecutive year, corporate profits were up. The number of business bankruptcies and failures continued to decline: bankruptcies dropped from 50,845 in 1994 to 50,516 in 1995 and failures declined from 71,558 in 1994 to 71,194 in 1995.

Overall, business prospered, particularly small businesses. Small-business-dominated industries added jobs at a rate greater than 1.6 times the national rate of increase of 1.6 percent. Small firms grew most in the retail and wholesale trade and service sectors.

The White House Conference on Small Business

An estimated 2,000 delegates gathered together in Washington, D.C. on June 11, 1995, to discuss the small business agenda to be submitted to Congress and President Clinton. By the end of the conference, the delegates had arrived at a final list of 60 policy recommendations. Among the recommendations were 11 tax policy issues, 14 capital formation and human capital issues, and six procurement issues. The 1995 WHCSB conference differed from the two preceding White House Conferences on Small Business because regional implementation chairpersons and issue chairs were elected for each of the 11 issue areas in the SBA's 10 regions. The SBA's Office of Advocacy has worked with the implementation chairs to ensure that their priorities are also the priorities of the Congress and the Administration. As of early 1997, 50 of the 60 issues had had some action, either administratively or legislatively. The implementation results can be seen in the appendix to Chapter 2.

Self-Employment and Small Business

An important small business development in recent years has been the increase in the number of self-employed people. From 1970 to 1994, the non-farm self-employed increased by more than 72 percent, from 5.2 million to 9 million. The self-employed accounted for nearly \$757 billion in business receipts in 1993. These smallest businesses help increase flexibility and adaptability in the economy, create new services and products, and add to the nation's productive capacity. Among the factors contributing to the increase in the self-employed are growth in the labor supply that is not readily accommodated by wage-and-salary employment, new unexploited opportunities, the hope of opportunities for greater financial returns, dissatisfaction with wage-

and-salary jobs, the need to supplement income, desire for independent work, and the rise in two-income earning families.

The self-employed have characteristics that distinguish them from wage-and-salary workers; for example:

- Overall, the self-employed are older than wage-and-salary workers. Of full-time workers, more than 41.7 percent of the unincorporated self-employed were between the ages of 45 and 64 in 1994, compared with only 28.8 percent of wage-and-salary workers.

- Self-employed workers are more likely to be married than wage-and-salary workers: about three-fourths of the self-employed are married, compared with less than 60 percent of full-time wage-and-salary workers.

- Vietnam and other veterans are slightly more likely to be in the self-employed category (8.6 percent) than the wage-and-salary category (6.28 percent).

- The self-employed have higher levels of formal education: More than 35 percent of the full-time self-employed had 4 or more years of college training, compared with less than 28 percent of wage-and-salary workers.

- Self-employed workers work longer hours per week and more weeks per year than those in paid employment.

- African and Hispanic Americans are less likely to be self-employed than the population as a whole, although their numbers are increasing.

- Men are more likely to be self-employed than women; however, the number of self-employed women is increasing rapidly. The number of unincorporated self-employed women has been increasing five times faster than their male counterparts.

Regulatory Relief for Small Firms

President Clinton signed the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) on March 29, 1996. The new law reinforces and strengthens the Regulatory Flexibility Act of 1980 (RFA) and provides small businesses more opportunities to take part in the federal regulatory process.

The 1980 RFA stipulated that federal agencies must examine the impact of their regulations on small businesses and offer reasonable alternatives to regulations having a significant disproportionate impact on small entities. SBREFA provides for “judicial review”—that is, it allows small businesses to take agencies to court in certain instances for noncompliance with the RFA. The 1996 legislation also provides assistance to small firms in addressing agency enforcement actions by requiring federal agencies to reduce penalties against small businesses, providing for improved economic analyses of regulatory impact, and condensing the overall regulatory process. SBREFA also provides for congressional review of federal agencies’ regulatory processes. To reap the full benefits of SBREFA, small businesses will need to participate actively in the federal regulatory process.

Innovation and Small Firms

The nation's future economic growth in technologies and industries is closely dependent on new technology-based firms (NTBFs). Since 1960, some 29,358 new high technology-based companies have been started. NTBFs have an important role to play in commercializing new technologies.

The federal government has implemented new policies and programs in support of these new technology-based firms, among them the Small Business Innovation Research (SBIR) program, the Small Business Technology Transfer (STTR) program, the Advanced Technology Program (ATP), the Manufacturing Extension Partnership (MEP) program, the Angel Capital Electronic Network (ACE-Net), and several SBA financing programs aimed toward high technology companies. These programs focus on commercialization potential, nonfinancial assistance, and the improvement of intellectual property rights protection. Overall, they aim to improve the process that allows small technology-focused businesses to participate in meeting federal research needs, creating new products and processes, and transferring these products into the commercial market.

Small Business Financing

Moderate growth in demand for credit and the easing of credit policy by the Federal Reserve Board contributed to declines in most interest rates in the credit markets in 1995. While increases in borrowing were moderate in U.S. domestic sectors overall in 1995, business borrowing surged to an annual rate of \$211 billion. Lending to small firms, including bank and finance company lending, increased significantly. Because large commercial and industrial loans were increasing so rapidly, however, the small business share of total loans declined slightly, from 40.4 percent in June 1994 to 39.2 percent in June 1995.

A booming stock market contributed to a very active small business equity market. Initial public offerings were up significantly and funds raised by venture capital firms reached a new high of \$4.4 billion.

Procurement from Small Firms

In FY 1995, small businesses acquired \$66.7 billion in federal contract awards, or 33 percent of the total \$202.3 billion in contract actions awarded by the federal government. The 1995 total was an increase from the previous year's 31.4 percent small business share valued at \$61.7 billion and from the 29.9 percent share in FY 1993.

Small minority-owned businesses won contracts worth \$1.5 billion (a 16.1 percent increase) and women-owned businesses won \$508.7 million in federal procurement dollars (a 22.0 percent increase). Small minority- and women-owned businesses' shares of federal procurement have been increasing steadily over the past several years.

Recent federal procurement reform legislation--the Federal Acquisition Streamlining Act of 1994 and the Federal Acquisition Reform Act of 1996—will have a significant impact on small business participation in the federal procurement process.

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Acknowledgments

The Annual Report on Small Business and Competition was prepared by the U.S. Small Business Administration under the leadership of Administrator Aida Alvarez and Chief Counsel for Advocacy Jere W. Glover. Bruce D. Phillips directed the Office of Economic Research. Kathryn J. Tobias directed the Office of Information.

The project was managed by Kathryn J. Tobias and Bruce D. Phillips. John Ward and Sarah M. Fleming made significant editorial contributions. Harriett A. Lyles, Marlene E. Delaney, Kathy Mitcham, and Darlene Mahmoud provided staff support. Specific sections were written or prepared by the following staff:

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The Office of Advocacy appreciates the interest of all who reviewed the report, including staff of the National Economic Council, the Council of Economic Advisers, and the Office of Management and Budget. Thanks are also extended to the U.S. Government Printing Office for their assistance.